

Yen File

This month's summiteers are likely to turn a blind eye to the subject. Even if a new deal for Britain can be negotiated in the summer, it will be designed to last only two or three years (like the 1980 agreement, which expires this year). Other EEC countries are determined to reopen the issue when the EEC runs out of money (the community's revenue from value-added tax is likely to reach its ceiling in 1983 or 1984). So the issue of who-pays-what will poison the community for years.

Breakfast for three?

The European leader best placed to attempt a revival of the community is President Mitterrand of France. Perhaps he should invite Mrs Thatcher and Mr Schmidt, during the coming summit meeting, to one of those breakfasts at which early-morning zeal enables tired people to sink their teeth into problems. Their three countries should then appoint a small group of non-bureaucrats to examine three problems.

1. Budget reform. The three-nation group should agree that the community has to be financed on the obvious principle that the poorer countries should pay no more—and if possible less—than the richer ones. There is no need to invent costly new spending policies to help the poorer brethren. Each country's net EEC payments should simply be adjusted to its share of community gdp.

2. Foreign policy. In principle, the European community should have a more organised way of working out what it thinks about the world, not least so that the United States could know "what Europe thinks". Any such mechanism runs into a conflict between the principle of universality (meaning that it speaks for the whole of the EEC) and the principle of efficiency (meaning a small enough group to speak clearly and quickly). The French proposal to blow the dust off the old seven-member Western European Union, and use it as a forum for discussing defence, falls neatly and rather unGallically between the two stools. It would include four out of the five big members or potential members of the EEC—France, West Germany, Britain and Italy, but not Spain—and only three of the seven smaller ones, who also want to be heard.

A foreign-policy secretariat would be a useful addition to the EEC's institutions. The main governments of western Europe often find their self-interest coinciding

ing: the American officials who came to Europe this week to see whether the west's economic relationship with the Soviet Union can be used to put a rein on Soviet foreign policy met a depressingly concerted rebuff in Bonn, Paris and London from governments that wish to continue business with Russia as usual. But where Europeans differ among themselves—for instance, about providing help to the United States for the protection of the Gulf—it would be wrong to create a mechanism in which those who want to do something could be vetoed by those who do not.

3. The main hope of saving the community is to resume the attempt to make it into a real common market. The Treaty of Rome contains ambitious and far-reaching provisions which call for the removal of all trade barriers within the community, and give the EEC commission wide powers to break up private and public cartels. These have never been fully implemented. That is why it is still possible for cars to be 40% dearer in Britain than in Belgium, why air fares in Europe are

The building of Europe is a great transformation which will take a very long time. . . . Nothing would be more dangerous than to regard difficulties as failures.

Jean Monnet

double American ones, and why there is too little cross-frontier competition in services such as banking and insurance.

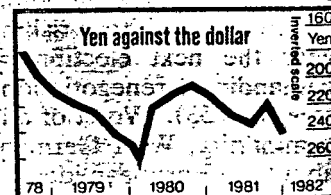
A reliance on these lines could yet break through the EEC deadlock. The attack has to be ordered by the governments of France, Germany and Britain. It needs a better front-line command in the Brussels commission, but it needs more than that. The European community was designed 25 years ago as a blend of supranational aspiration and very nationalist reality. It was seen as a better place for commercial and political battles to be fought out than on those earlier battlefields in Europe, studded with millions of crosses of the dead. Any organisation committed by design to ceaseless internal struggle is always in danger of wearying its audience: particularly an audience hurt by recession and threatened by rockets. Unless, that is, the elected political leaders of the club can find the vision and the will to force their governments to resolve, instead of fudge, their conflicts once again.

A yen too cheap

How to make recession-hit Japanese consumers love currency appreciation

Britain's national institute for economic research recently forecast that Japan's current overseas surplus would swell to \$24 billion in 1982 and \$33 billion in 1983, even though the institute seemed to be assuming a 17% upvaluation of the yen against the dollar by early 1983 and no real fall in the oil price. As nearly 50% of Japan's imports are oil and other fuel, any further

weakening of Opec will presumably send that surplus and the yen through the roof, especially if (see page 71) Japanese industry becomes even hungrier for export orders because it is entering a minirecession. Yet the yen weakened again this week, and Japanese consumers are now paying an expensive Y241 for each dollar's worth of goods, versus Y177 at one stage in 1978. The



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yen is becoming further and further undervalued, for two bad reasons.

First, some Japanese businessmen say:

Because the yen is not an international currency, 98% of imports into Japan are billed in foreign exchange (mainly dollars), so any yen upvaluation quickly makes foreign goods cheaper than Japanese ones, causing disruption. . .

Answer: hurrah. This is an argument that upvaluation would bring higher Japanese imports of foreign things that the Japanese want, which is good for everybody. At present the low yen is a main reason why western quotas are being erected against the export of the Japanese things that westerners most want, which is bad for everybody.

Second, the yen is low because Japanese interest rates are low. Some bank interest rates this week:

	3-month bank deposits %	Prime rates %
USA	14.55	16.1
Britain	13.50	14
France	15.00	14
West Germany	9.10	13
Japan	3.75	6

At first blush, some Tokyo officials will claim that these cheap Japanese interest rates are entirely explained by Japan's present low 3% inflation and by high Japanese savings. At second blush, they will admit what the figures make obvious:

We Japanese do artificially cut ourselves off from ridiculously high American interest rates, and that is one reason for our economy's success. You in Europe would be wise to do the same.

If people could understand which half of this last argument is sensible, and which half is muddle, it should be possible to reach an agreement of benefit to both western and Japanese consumers.

Banks, but not for consumers

Under Japan's infuriatingly named Temporary Interest Rates Adjustment Law of 1947, Japan has long rationed bank credit by quantitative restrictions instead of by price. In the 1950s and 1960s the banks pumped out cheap credit to big related firms (eg, the Mitsubishi bank to Mitsubishi companies). When the economy was overheated, the Bank of Japan would slam shut the credit window. The banks would then continue cheap credit to their big insiders, but stop all credit to unprofitable outsiders like clog-makers abruptly. This proved a brilliant way of building new Japanese industries and killing old clog-makers.

In the 1974 oil shock Japan's inflation went well above 20%, but bank deposit rates stayed at around 5½%, showing that Japan's interest rates really are not market-directed. Industrial investment dropped sharply, so that the big companies could suddenly finance more of it out of their (not greatly reduced) retained profits. That drop in investment threatened to cause a slump, which the Japanese government met by straight Keynesianism, sending its budget deficit in 1978 to 5½% of gnp. The government rushed through some more

public works this week because of a small fall in real gnp in the October-December quarter. The Japanese budget deficit is financed by placing government bonds with the banks at uneconomically low interest rates, so that Japanese banks have moved from being industry-subsidising organisations into becoming government-subsidising organisations.

Both sorts of subsidy have been paid for by the Japanese consumer, to whom the banks have until recently displayed what a foreign banker has called "characteristics . . . closer to those of the moneylender than of a modern consumer finance operation". Compared with the average westerner the average Japanese has to save very heavily (instead of being subsidised by tax concessions to borrow) when buying a house; he may still amass £100 for each of his three television sets instead of getting them on the hire purchase (although this is now changing); he has to make large savings to supplement his inadequate and largely unsubsidised pension in old age; he has to keep a nest-egg against sudden emergencies since he is likely to be underinsured because the government-sanctioned cartel of insurance companies is almost ordered to offer him rotten insurance terms. The consequence of all this is that consumption in Japan has consistently taken 5-10% less of gnp than it does in the United States, and this missed-out 5-10% is called "the average Japanese's admirably higher rate of saving". The savings go into low-interest government bonds and various sorts of savings bank deposits—partly because these carry tax concessions per account held (so that there are three times as many savings bank accounts as there are Japanese).

Six gains, but too much of a good thing

There is some good sense in this Japanese rigging of their capital market. The Americans and most Europeans have lower savings and lower investment and lower innovation and lower productivity growth, higher inflation and arguably a less cohesive society, partly because they oversubsidise borrowing for house purchase and pay index-linked pensions from the central government to each granny instead of expecting her to get some help from her individual grandchildren; the Japanese do better on all six scores partly because they do the reverse. But some part of the forced saving on Japanese consumers must now be economic nonsense. Some time freer competition is going to have to be allowed in Japanese insurance. Greater competition is going to have to be allowed in bidding up for Japanese deposits in various sorts of other institutions, so as to lend more to Japanese consumers and others. That includes international competition. A main reason why foreign countries hold only about 4% of their reserves in yen is their feeling that you cannot always use yen as changing market conditions dictate, because administrative guidance from the Japanese authorities will be telling other people to use their yen in a way which will suddenly make your most logical decision into nonsense.

The entry of more consumers as borrowers would raise Japanese interest rates. This, together with greater internationalisation, would bring appreciation of the

yen. That appreciation is surely almost inevitable anyway. The greatest mistake in this recession would be for Japanese financial institutions to lean against upvaluation, as a way of keeping their exports more profitable. This week it has been possible to buy Y240m with \$1m. Unless there is another oil shock

through a coup in Saudi Arabia or somewhere, or unless Japanese exports are to be checked by very undesirable protectionism, it seems a reasonable bet that these Y240m will be worth nearer to \$1.3m some time before the end of 1983. The faster that speculators send the yen up there, the better.

Undermining Mr Whitelaw

Mrs Thatcher is girding herself to make law and order an election issue. She should beware



Britain's crime figures were awful in 1981, but less awful than the headlines said. The most violent crimes—rape, murder, assault—were all down on the previous year. The serious increases were in theft from cars (up by 29% to 380,000) and the much smaller total of robbery (up 35% but only to just over 20,000). There were at the same time more, and better paid, policemen on the streets. And since more police tend to record more crime, such increases as there have been are probably in part a statistical abstraction. The law is still hemmed about with archaic, and restrictive, practices. Britain's prisons are still a national disgrace. But the picture is less than wholly gloomy.

So why is Mrs Margaret Thatcher's Conservative party in a sudden ferment over law and order? Why is Britain's amiable home secretary, Mr William Whitelaw, under siege? Why has the prime minister—using her unpaid spokesmen, the lobby correspondents—reportedly expressed "serious anxiety" about the crime figures and affirmed she is "devoting more of her time to law and order"? Why add that she would not "tolerate" criticism of Mr Whitelaw and was "briefing herself for a counter-attack against his critics"?

These phrases, decoded, do not support Mr Whitelaw. They undermine him. They confirm the suspicion that Mrs Thatcher would like to dispense with a particularly loyal colleague in search of a new presentation if not a new policy. This she may shortly do.

Mrs Thatcher is testing the water on what she reckons might be a central theme of her next general election campaign, at most two years away. The economy may by then be just on the turn, but attention will need to be deflected from the after-effects of recession, especially high unemployment. What better than to plead the condition of society needs her prime attention: the quality of family life, educational standards, and, above all, maintenance of the law and social discipline? Such a platform appeals to Mrs Thatcher personally as well as electorally—always a happy coincidence for a politician. And it can be made studiously vague in both exposition and resolution.

Law and order are easier to prescribe than to implement in any western democracy. In British, as in American, election campaigns, they have become a cry of communal anguish, which irresponsible statesmen exploit but responsible ones temper. In Britain it has been persistently unimportant to the mass electorate,

except where politicians choose to make it otherwise. At the last election, when a real controversy such as union reform was declared "most important issue" by 51% of respondents in a Mori poll, law and order rated 3%. This February law and order was down to 2%, alongside 66% for unemployment and 12% for inflation. To raise law and order from this dormant position will require Herculean efforts of press distortion (no problem this, to last week's tabloid media) but also politicians ready to exploit this distortion.

What would all this mean for wavering Conservative supporters? Here is a party which until last month was Britain's least popular government since the war. Now, after two years of pain, it seems that the price demanded of the electorate might after all have been worth paying. Moderate Tories, many of whom flocked in panic to the centre parties, might now be tempted back by a shrewd colonisation (at least in social policy) of the political centre: why else the more-than-necessary uprating of social benefits in the recent budget? Yet these are precisely the supporters most likely to be deterred by the artificial whipping up of an issue which is to the Tory party what "soaking the rich" has long been to Labour.

Hoist with their own rope?

The medium-term policy strategy for the Conservative party is now on a knife-edge, as its leaders contemplate the next election. The party is a much broader church than Labour, drawing immense strength, in good years, from a membership in which a no-nonsense but tolerant majority has usually been able to keep extremism at bay. One result has been a markedly higher calibre, lately, of members of parliament. Much of this broad church, disillusioned with the party's conduct of the economy, spent 1981 at home, even venturing out to see the SDP chapel. As a result, constituency parties have been left to activists, often on the party's political extreme—a phenomenon similar to that more publicised for Labour.

It was these activists who surprised observers by voting down Mr Whitelaw's moderate law and order motion at the last party conference—to Mrs Thatcher's apparent, astonishing, approval. They are the people who regard themselves as the prime minister's storm-troopers against the wet tendency, and resent bitterly her cabinet's undermining of her position. It is they